KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

brian.odonovan@kpmgifrg.com

Dr. Andreas Barckow
International Accounting Standards Board
Columbus Building
7 Westferry Circus
London
E14 4HD

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Dear Dr. Barckow

Comment letter on Exposure Draft Business Combinations—Disclosures, Goodwill and Impairment

We appreciate the opportunity to comment on the International Accounting Standards Board's (IASB) Exposure Draft ED/2024/01 Business Combinations—Disclosures, Goodwill and Impairment ('the ED') published in March 2024. We have consulted with, and this letter represents the views of, the KPMG network.

We support the IASB's efforts to improve the disclosure of information about business combinations in IFRS 3 *Business Combinations*. We acknowledge the demand from users for better information to help them assess the performance of a business combination. However, we have significant concerns about the proposed quantitative disclosures about estimated expected synergies and information about the performance of a business combination.

The nature and source of this information is different from existing disclosure requirements in IFRS® Accounting Standards. While we recognise stakeholder requests for this information, requiring it in the financial statements introduces new complexities and could create a new expectation gap. We believe further clarity is needed about preparers' and auditors' responsibilities over this information and how this will be communicated to users. We recommend the IASB consult further with auditors, auditing standard setters, and regulators on this matter.

We generally agree with the IASB's proposed changes to IAS 36 *Impairment of Assets* and recommend that these amendments proceed independently of the proposed IFRS 3 amendments. However, we believe that the proposed changes aimed at reducing shielding and management over-optimism will not be sufficient to resolve these issues. To do that, additional guidance and disclosures are needed. We also believe that clarifications, application guidance and examples are needed in certain instances – e.g. in relation to the proposed changes to how an entity calculates value in use.

The appendix to this letter contains our detailed responses to the questions raised in the ED.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Peter Carlson at pcarlson@kpmg.com.au if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix

This appendix contains our detailed responses to the questions raised in the ED.

Question 1—Disclosures: Performance of a business combination (proposed paragraphs B67A–B67G of IFRS 3)
In the PIR of IFRS 3 and in responses to the Discussion Paper the IASB heard that: • users need better information about business combinations to help them assess whether the price an entity paid for a business combination is reasonable and how the business combination performed after acquisition. In particular, users said they need information to help them assess the performance of a business combination against the targets the entity set at the time the business combination occurred (see paragraphs BC18–BC21). • preparers of financial statements are concerned about the cost of disclosing that information. In particular, preparers said the information would be so commercially sensitive that its disclosure in financial statements should not be required and disclosing this information could expose an entity to increased litigation risk (see paragraph BC22). Having considered this feedback, the IASB is proposing changes to the disclosure requirements in IFRS 3 that, in its view, appropriately balance the benefits and costs of requiring an entity to disclose this information. It therefore expects that the proposed disclosure requirements would provide users with more useful information about the performance of a business combination at a reasonable cost. In particular, the IASB is proposing to require an entity to disclose information about the entity's acquisition-date key objectives and related targets for a business combination and whether these key objectives and related targets are being met (information about the performance of a business combination). The IASB has responded to preparers' concerns about disclosing that information by proposing: • to require this information for only a subset of an entity's business combinations— strategic business combinations (see question 2); and • to exempt entities from disclosing some items of this information in specific circumstances (see question 3). (a) Do you agree with the IASB's proposal to require an entity to disclose information about the performance of a strategic business combination, subject to an exemption? Why or why not? In responding, please consider whether the proposals appropriately balance the benefits of requiring an entity to disclose the information with the costs of doing so. (b) If you disagree with the proposal, what specific changes would you suggest to provide users with more useful information about the performance of a business combination at a reasonable cost?

We generally agree that disclosure should be required only for a subset of business combinations and that entities should be exempt from disclosing certain information under specific circumstances. However, we have some comments regarding the criteria used to determine the subset and practical application of the exemption, which are discussed further in Questions 2 and 3.

Question 2—Disclosures: Strategic business combinations (proposed paragraph B67C of IFRS 3)

The IASB is proposing to require an entity to disclose information about the performance of a business combination (that is, information about the entity's acquisition-date key objectives and related targets for the business combination and whether these key objectives and related targets are being met) for only strategic business combinations—a subset of material business combinations. A strategic business combination would be one for which failure to meet any one of an entity's acquisition-date key objectives would put the entity at serious risk of failing to achieve its overall business strategy.

The IASB is proposing that entities identify a strategic business combination using a set of thresholds in IFRS 3—a business combination that met any one of these thresholds would be considered a strategic business combination (threshold approach) (see paragraphs BC56–BC73).

The IASB based its proposed thresholds on other requirements in IFRS Accounting Standards and the thresholds regulators use to identify particularly important transactions for which an entity is required to take additional steps such as providing more information or holding a shareholder vote. The proposed thresholds are both quantitative (see paragraphs BC63–BC67) and qualitative (see paragraphs BC68–BC70).

(a) Do you agree with the proposal to use a threshold approach? Why or why not? If you disagree with the proposal, what approach would you suggest and why?

(b) If you agree with the proposal to use a threshold approach, do you agree with the proposed thresholds? Why or why not? If not, what thresholds would you suggest and why?

We agree with the use of a threshold approach, as we believe it is simpler to apply and less subjective compared to a principles-based approach.

However, we believe modifications are needed to operationalise the thresholds and ensure they capture the relevant population of transactions (i.e. limited only to those acquisitions that are strategic), and that the approach can be applied at a reasonable cost. We also recommend including the definition of a strategic business combination in the standard to support application of the thresholds as discussed further below.

The description of a strategic business combination in paragraph BC54 ("one for which failure to meet any one of an entity's key objectives would put the entity at serious risk of failing to achieve its overall business strategy") does not appear to align with the proposed 10% threshold. We believe that a higher threshold would better align with the description (e.g. 15%–20%).

In addition, even if the thresholds were to be higher, there is a risk that the approach may capture some business combinations that are not strategic (i.e. 'false positives'), particularly due to application of the operating profit or loss threshold and the qualitative threshold, as explained below.

Operating profit or loss can fluctuate significantly from one period to another and can be impacted by non-recurring amounts like impairment losses. Consequently, what meets the threshold for a given acquirer might vary considerably from year to year. Furthermore, for some acquirers, operating profit may be very small or breakeven, meaning any acquisition would meet this quantitative test. Similarly, the qualitative threshold as currently drafted would appear to be met any time an acquiree has operations in a new jurisdiction, regardless of how important that acquisition is to the entity's overall business strategy. To reduce the potential for such false positives, we recommend the IASB:

- reconsider whether a single annual profit or loss amount should be a threshold on its own; and
- revise the description of the qualitative threshold in B67C to match the wording from BC55: "entering a new ~~major~~ line of business or geographical area of operations **that is essential to the entity's overall business strategy**."

We also believe a mechanism in addition to the thresholds would be useful in addressing the possibility of false positives. For example, this could be achieved by including the definition of a strategic business combination in the standard and making the thresholds a rebuttable presumption with factors for preparers to consider and disclosure that it has been applied.

We believe that without further clarification, the proposed use of the acquiree's financial information when applying the quantitative thresholds will present practical challenges. For instance, it is unclear:

- whether the acquiree's most recent revenue and operating profit or loss should be based on IFRS Accounting Standards, which could be costly if the acquiree applies a different GAAP.
- how to deal with differences in annual reporting periods. For example, is it acceptable to compare the acquirer's most recent annual reporting period with the acquiree's if they represent different periods?
- whether the information needs to be based on audited financial statements, as these may not always be available. For example, if the acquiree is not a legal entity but a collection of assets and liabilities that meet the definition of a business (a

‘carve-out’ acquiree) relevant historical information on profit or loss may not be available.

Furthermore, we believe the IASB should clarify the interaction (or lack thereof) between the proposals and IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. The proposed qualitative thresholds are based on the criteria in IFRS 5 for identifying discontinued operations, but applied ‘in reverse’ for identifying strategic business combinations. This raises questions about how the thresholds might affect future classifications of disposals. For example, if a business combination was initially considered strategic because it was assessed as a major line of business at the time, but the acquired business later becomes less significant due to the growth of other business lines, would the previous identification as a strategic business combination make it harder to argue that the disposal is not a major line of business (and therefore not a discontinued operation under IFRS 5.32)?

Question 3—Disclosures: Exemption from disclosing information (proposed paragraphs B67D–B67G of IFRS 3)

The IASB is proposing to exempt an entity from disclosing some of the information that would be required applying the proposals in this Exposure Draft in specific circumstances. The exemption is designed to respond to preparers’ concerns about commercial sensitivity and litigation risk but is also designed to be enforceable and auditable so that it is applied only in the appropriate circumstances (see paragraphs BC74–BC107).

The IASB proposes that, as a principle, an entity be exempt from disclosing some information if doing so can be expected to prejudice seriously the achievement of any of the entity’s acquisition-date key objectives for the business combination (see paragraphs BC79–BC89). The IASB has also proposed application guidance (see paragraphs BC90–BC107) to help entities, auditors and regulators identify the circumstances in which an entity can apply the exemption.

(a) Do you think the proposed exemption can be applied in the appropriate circumstances? If not, please explain why not and suggest how the IASB could amend the proposed principle or application guidance to better address these concerns.

(b) Do you think the proposed application guidance would help restrict the application of the exemption to only the appropriate circumstances? If not, please explain what application guidance you would suggest to achieve that aim.

Given the concerns from preparers about commercial sensitivity and litigation risk, we expect them to seek to apply the exemption frequently. However, we believe it will be difficult for preparers to provide evidence justifying application of the exemption (and for auditors to evaluate this judgement). This could lead to disagreements between preparers and auditors, and disagreements between preparers and regulators. Therefore, we believe the proposed exemption and related application guidance needs to be further clarified to ensure it can be operationalised and restrict application to the appropriate circumstances.

While the non-exhaustive list of factors is helpful in determining when the exemption is inappropriate, we believe it may still be difficult for preparers and auditors to assess whether a specific reason is sufficient and whether there is evidence to support the expected effect of disclosing the information.

Additional guidance in the draft Basis for Conclusions, including examples of when the exemption could be applied and when it could not be applied in the context of litigation risk, is useful. We believe it would be helpful if this guidance was incorporated within the text of the standard (as application guidance or illustrative examples) to help clarify the intended scope of the exemption and assist in making and auditing this judgement.

We also recommend that the IASB clarify its expectations regarding the disclosure of the "reason for applying the exemption" as proposed in paragraph B67E, as it is currently unclear how this can be practically achieved for each item of information without disclosing detailed information about the exempted item(s). This could be achieved through illustrative examples.

We also suggest revising the discussion of the exemption in paragraph 62B to reflect that the exemption will not always be available: "The acquirer ~~is~~ **might be** exempt from disclosing some of the information…"

Question 4—Disclosures: Identifying information to be disclosed (proposed paragraphs B67A–B67B of IFRS 3)
The IASB is proposing to require an entity to disclose information about the performance of the entity's strategic business combinations (that is, information about its acquisition-date key objectives and related targets for a strategic business combination and whether these key objectives and related targets are being met) that is reviewed by its key management personnel (see paragraphs BC110–BC114). The IASB's proposals would require an entity to disclose this information for as long as the entity's key management personnel review the performance of the business combination (see paragraphs BC115–BC120). The IASB is also proposing (see paragraphs BC121–BC130) that if an entity's key management personnel: • do not start reviewing, and do not plan to review, whether an acquisition-date key objective and the related targets for a business combination are met, the entity would be required to disclose that fact and the reasons for not doing so; • stop reviewing whether an acquisition-date key objective and the related targets for a business combination are met before the end of the second annual reporting

> period after the year of acquisition, the entity would be required to disclose that fact and the reasons it stopped doing so; and
>
> - have stopped reviewing whether an acquisition-date key objective and the related targets for a business combination are met but still receive information about the metric that was originally used to measure the achievement of that key objective and the related targets, the entity would be required to disclose information about the metric during the period up to the end of the second annual reporting period after the year of acquisition.
>
> (a) Do you agree that the information an entity should be required to disclose should be the information reviewed by the entity's key management personnel? Why or why not? If not, how do you suggest an entity be required to identify the information to be disclosed about the performance of a strategic business combination?
>
> (b) Do you agree that:
>
> (i) an entity should be required to disclose information about the performance of a business combination for as long as the entity's key management personnel review that information? Why or why not?
>
> (ii) an entity should be required to disclose the information specified by the proposals when the entity's key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period? Why or why not?

We generally agree with the proposal to require disclosure of information reviewed by key management personnel. We recommend clarifying that this includes *any* key management personnel, as this term can encompass more than one level of management.

However, we have the following significant concerns. We recommend that the IASB reconsiders the statements in BC145 about the auditability of the proposals. As currently drafted it is unclear whether the IASB expects the auditor to:

- (Approach 1) Confirm the information disclosed is indeed the information that was reviewed by key management personnel, or
- (Approach 2) Confirm both that the information disclosed is the information that was reviewed as under Approach 1 and also confirm the information disclosed is reasonable.

We are concerned that Approach 2 may not be practicable for preparers and auditors, or capable of being implemented at a reasonable cost. This is because:

- There is no measurement framework for preparing the information.

- The information does not originate from the usual financial reporting systems and processes and is not subject to the related internal controls over financial reporting.
- There would be challenges regarding the reliability and verifiability of the information, particularly if the information is non-financial (e.g. market share).

We believe Approach 1 could be implemented practicably and at a reasonable cost. However, we recommend that the IASB takes the following steps before proceeding with an Approach 1 version of the proposals.

It is important that the standard explicitly clarifies the purpose and nature of the disclosures and the responsibilities of those charged with governance over them. This could include stating in the authoritative text of IFRS 3 that the purpose is to disclose the information that management used in deciding to make the acquisition and the information that it reviews in tracking performance (regardless of whether this information is reasonable or supportable). We also recommend that, to inform users, IFRS 3 be amended to require clear disclosures in the financial statements about the nature and purpose of the information.

While these changes could help to clarify that the responsibility of the auditor is solely to verify that the information disclosed in accordance with the requirements of the financial reporting framework is indeed what was reviewed by management, we believe the IASB should perform further outreach to reduce the risk of potential misunderstandings arising about the nature of assurance provided over such information, and to understand whether the inclusion of such information in the financial statements may have potential implications for the auditor's report. For example, this outreach might consider whether, if this information is disclosed in the notes to the financial statements, the auditor may consider it necessary to set out their responsibilities relating to the audit of these disclosures in an 'other matter' paragraph to avoid potential misunderstandings about the nature of the assurance on this information. In addition, the outreach might consider whether the auditor may use an 'emphasis of matter' paragraph that refers to information disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements (such as disclosure clarifying the nature of the information and the purpose of disclosing it).

We recommend the IASB consult further with auditors, auditing standard setters, and regulators on these matters.

Once the auditability implications have been further clarified, we recommend the IASB reconfirm with the user community that this information would still be useful and justify the related costs.

Other observations

Regarding the proposed qualitative statement per B67A(b)(ii), we suggest clarifying whether the statement needs to be made for each key objective and target, or collectively (e.g. if some have been met and others have not). It is also unclear how an entity can state whether actual performance "is meeting or has met" an objective or target that is set at a future date after the end of reporting period. We note the illustrative example uses the phrase “Performance to date is in line with expectation”, however this seems to be a slightly different concept and implies an entity needs to have expected targets or some measure of progress as of each reporting date to make such a statement.

The types of objectives and targets can vary widely, especially for ‘non-traditional’ business combinations (e.g. situations where there is a bargain purchase, business combination by contract alone, combination of mutual entities, etc.). We recommend including additional examples to illustrate how the requirements should be applied to a broader range of types of strategic business combinations. For example, an illustrative example of a business combination that only meets the qualitative threshold could help users understand the IASB’s expectations and how disclosures could vary based on different strategic rationales. This example could involve entering a new major line of business, where key objectives and related targets might relate to, for example, the number of new franchise stores opened, the development of a new product line by a certain date, or where goodwill may relate solely to the acquired workforce and retention may be a key objective. In addition, in situations where there is a bargain purchase, it would be important for the IASB to clarify if it expects the same level of disclosures as a transaction with significant goodwill.

Duration of disclosures

We agree that an entity should be required to disclose information about the performance of a business combination for as long as the entity’s key management personnel review that information.

We also agree that an entity should be required to disclose the specified information when the entity’s key management personnel do not start or stop reviewing the achievement of a key objective and the related targets for a strategic business combination within a particular time period.

Question 5—Disclosures: Other proposals
The IASB is proposing other amendments to the disclosure requirements in IFRS 3. These proposals relate to: *New disclosure objectives (proposed paragraph 62A of IFRS 3)* The IASB proposes to add new disclosure objectives in proposed paragraph 62A of IFRS 3 (see paragraphs BC23–BC28). *Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)* The IASB proposes:

- to require an entity to describe expected synergies by category (for example, revenue synergies, cost synergies and each other type of synergy);
- to require an entity to disclose for each category of synergies:
  - the estimated amounts or range of amounts of the expected synergies;
  - the estimated costs or range of costs to achieve these synergies; and
  - the time from which the benefits expected from the synergies are expected to start and how long they will last; and
- to exempt an entity from disclosing that information in specific circumstances.

See paragraphs BC148–BC163.

The strategic rationale for a business combination (paragraph B64(d) of IFRS 3)

The IASB proposes to replace the requirement in paragraph B64(d) of IFRS 3 to disclose the primary reasons for a business combination with a requirement to disclose the strategic rationale for the business combination (see paragraphs BC164–BC165).

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

The IASB proposes to amend paragraph B64(q) of IFRS 3 to improve the information users receive about the contribution of the acquired business (see paragraphs BC166–BC177). In particular, the IASB proposes:

- to specify that the amount of profit or loss referred to in that paragraph is the amount of operating profit or loss (operating profit or loss will be defined as part of the IASB's Primary Financial Statements project);
- to explain the purpose of the requirement but add no specific application guidance; and
- to specify that the basis for preparing this information is an accounting policy.

Classes of assets acquired and liabilities assumed (paragraph B64(i) of IFRS 3)

The IASB proposes to improve the information entities disclose about the pension and financing liabilities assumed in a business combination by deleting the word 'major' from paragraph B64(i) of IFRS 3 and adding pension and financing liabilities to the illustrative example in paragraph IE72 of the Illustrative Examples accompanying IFRS 3 (see paragraphs BC178–BC181).

Deleting disclosure requirements (paragraphs B64(h), B67(d)(iii) and B67(e) of IFRS 3)

The IASB proposes to delete some disclosure requirements from IFRS 3 (see paragraphs BC182–BC183).

Do you agree with the proposals? Why or why not?

While we generally agree with these proposals, we believe that those related to the quantitative disclosures about expected synergies need further clarification and modifications. As currently proposed, we believe there will be significant challenges in effectively implementing and auditing these disclosures.

Requirements to disclose quantitative information about expected synergies in the year of acquisition (proposed paragraph B64(ea) of IFRS 3)

We understand a key part of the rationale for requiring disclosures about expected synergies is to help users better understand the price paid and the amount of goodwill recognised. However, to ensure relevant and meaningful disclosures, we believe the proposals should further narrow when the disclosure is required and clarify the nature of the information to be provided.

i. The relationship between the existing requirement in B64(e) and the new requirement in B64(ea) should be clarified so that quantitative disclosure of expected synergies is only required when synergies contribute to goodwill (e.g. when they were a benefit the entity expected from the business combination when agreeing on the price as described in 62A(a)). In some cases, synergies may not drive the acquisition decision or price (e.g. in a defensive acquisition), yet the disclosures appear to be required in all cases.

ii. The proposals should also clarify whether the amounts to be disclosed are those prepared and reviewed by management when deciding to make the acquisition and agreeing on its price (i.e. a management view similar to key objectives and targets), or amounts prepared to meet the disclosure requirement and explain what makes up the amount of goodwill recognised. We note that this distinction could be important in some cases (e.g. when goodwill is influenced by market movements in share prices after the price has been negotiated between the parties to the transaction, considering market expectations about expected synergies). In such cases, the originally expected synergies estimated by management may not align with the goodwill ultimately recognised. Alternatively, the acquisition price agreed by management may be determined based on an anticipated internal rate of return (IRR), without explicitly considering the expected synergies.

Similar to our comments on Question 4, the IASB's expectation of the auditor's responsibilities is not clear. If auditors need to confirm the amount of synergies is reasonable (our Approach 2 in Question 4), we have significant concerns about how this can be operationalised at a reasonable cost. These amounts would appear to be accounting estimates as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and subject to extensive audit procedures for such estimates, including consideration of management bias. However, we note that expected synergies are different from other forward-looking accounting estimates in the financial statements, including the following important differences:

- ‘Synergies’ is not a defined term in IFRS Accounting Standards and there is no related measurement framework for making such an estimate.
- It relies on information about the operations of an entity outside of the group which is often significantly limited and inherently imprecise at the time the purchase price is negotiated.
- It involves estimating the results of a hypothetical combined (post-acquisition) reporting entity which does not exist yet.
- There are a wide range of different factors which will influence the assessment and realisation of synergies for a particular business combination, which means there are very few benchmarks or public information which can be reliably used to inform the assessment of synergies.
- There is often inherent uncertainty in the timing of when the transaction will close (only after which can synergies begin to be realised by the acquirer) which impacts the financial information used.

All of these differences create unique challenges for preparers and auditors with risks of inconsistency, complexity, subjectivity and significant costs, as specialised knowledge and resources would be required to prepare and audit such an estimate.

We have observed that in jurisdictions where assurance is provided over expected synergies (e.g. in the United Kingdom Takeover Code), it is limited to assurance over the announced synergies being prepared ‘on the basis stated’, not reasonable assurance over the estimate itself due to these inherent limitations.

For the disclosure of expected synergies to be achieved in the financial statements at a reasonable cost that justifies the benefits, we believe the disclosure would need to follow a management view, with verification by auditors that it is the amount of synergies that was considered by management when deciding on the purchase price. This would be similar to our Approach 1 discussed under Question 4 and the same recommendations discussed in Question 4 would also apply.

If the proposals were to proceed under our Approach 2, we believe it is essential that, in addition to further clarifying when the disclosure is required and the nature of the information to be provided (issues i and ii), the proposals define the term synergies in the standard and provide guidance on how synergies should be measured under IFRS Accounting Standards. The IASB should also consider how the costs of requiring this new estimate in the financial statements compares to the benefits in the context of the larger project, which aims to simplify some of the long-standing complexities of the value in use (VIU) estimate under IAS 36, while at the same time introducing a new highly subjective estimate that may have even more estimation uncertainty.

Contribution of the acquired business (paragraph B64(q) of IFRS 3)

We agree with specifying that the basis for preparing this information is an accounting policy. However, we ask that the IASB add clarification directly in IFRS 3.B64(q) that its expectation is for entities to disclose information about the basis of preparation of combined entity information to the extent that the information is material (i.e. to specify that the basis for preparing this information is an accounting policy).

Question 6—Changes to the impairment test (paragraphs 80–81, 83, 85 and 134(a) of IAS 36)

During the PIR of IFRS 3, the IASB heard concerns that the impairment test of cash-generating units containing goodwill results in impairment losses sometimes being recognised too late.

Two of the reasons the IASB identified (see paragraphs BC188–BC189) for these concerns were:

- shielding; and
- management over-optimism.

The IASB is proposing amendments to IAS 36 that could mitigate these reasons (see paragraphs BC192–BC193).

Proposals to reduce shielding

The IASB considered developing a different impairment test that would be significantly more effective at a reasonable cost but concluded that doing so would not be feasible (see paragraphs BC190–BC191).

Instead, the IASB is proposing changes to the impairment test (see paragraphs 80–81, 83 and 85 of IAS 36) to reduce shielding by clarifying how to allocate goodwill to cash-generating units (see paragraphs BC194–BC201).

Proposal to reduce management over-optimism

The IASB's view is that management over-optimism is, in part, better dealt with by enforcers and auditors than by amending IAS 36. Nonetheless, the IASB is proposing to amend IAS 36 to require an entity to disclose in which reportable segment a cash-generating unit or group of cash-generating units containing goodwill is included (see paragraph 134(a) of IAS 36). The IASB expects this information to provide users with better information about the assumptions used in the impairment test and therefore allow users to better assess whether an entity's assumptions are over-optimistic (see paragraph BC202).

(a) Do you agree with the proposals to reduce shielding? Why or why not?

(b) Do you agree with the proposal to reduce management over-optimism? Why or why not?

(a) *Proposals to reduce shielding*

We generally agree with the IASB's proposed changes in paragraphs 80, 80A, 80B, 81 and 83(b). That said, the last sentence in paragraph 80A(b) implies that the financial information that management regularly uses to monitor the business associated with the goodwill needs to reflect how the benefits expected from the synergies of the combination are managed. However, the financial information that management at the lower level uses to monitor the business may not reflect how the benefits expected from the synergies are managed. In such a case, goodwill will be allocated at a higher level. We therefore recommend removing the last sentence in paragraph 80A(b).

The proposed changes should help to clarify the current requirements of IAS 36 regarding the allocation of goodwill to CGUs or groups of CGUs. However, we do not anticipate these changes will significantly reduce the "shielding effect". Therefore, we recommend that the IASB, in addition to the proposed changes, introduce more substantial changes to lessen it. This could include adding guidance on CGU identification and the methods for allocation and reallocation of goodwill to CGUs. There is limited guidance in this area in IAS 36.

- CGU identification: Identifying CGUs requires judgement and can be one of the most difficult areas of impairment accounting. Application guidance would help preparers identify groups of assets that have largely independent cash inflows. For example, key factors to consider such as revenue separation (i.e. are the streams of revenue derived from groups of assets independent of one another?) and asset separation (i.e. are assets operated together to such an extent that they do not generate independent revenue streams?).[1]

- Goodwill allocation methods: Application guidance on goodwill allocation methods and on the key factors to consider when choosing the method of allocation would be very helpful for preparers. For example, the pre-acquisition analysis of the acquirer may be useful in allocating the goodwill to CGUs. This analysis may indicate the drivers behind the synergies that are expected to arise from the acquisition.[2] Guidance in this area would be useful not only for allocation of goodwill to CGUs in accounting for a business combination, but also for goodwill reallocation in the event of reorganisation or disposal of a CGU containing goodwill. The current requirement in paragraph 86 of IAS 36 to perform the reallocation on the basis of relative values (unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of) is unclear and raises questions in practice. The same issue arises in the case of a reorganisation when an entity changes the composition of its CGUs and reallocates goodwill.

[1] Guidance on this topic is included in KPMG's Insights into IFRS 3.10.70-80.
[2] Guidance on this topic is included in KPMG's Insights into IFRS 3.10.450.

(b) *Proposal to reduce management over-optimism*

The proposal assumes that segment information usually provides a good benchmark for assessing the reasonableness of the assumptions used in estimating the CGU's cash flows. However, this is only true if the CGU (or group of CGUs) tested for impairment makes up a large part (or all) of the reportable segment. In other cases, this disclosure may not be useful – for example, if the segment is based on geographical areas and a CGU within the segment represents cash inflows from a particular business (out of several in that segment).

To tackle management over-optimism, we suggest adding a requirement to disclose implied valuation multiples against relevant market multiples (e.g. industry multiples) or key assumptions against market parameters (e.g. profit margin and growth rates in the relevant industry) as available, together with a qualitative disclosure explaining the reasons for differences. This may encourage entities to take a closer look at the assumptions used in calculating VIU and may instil greater discipline in the impairment process at a reasonable cost. Another suggestion is to require disclosure of how much each key assumption would need to change for the CGU to break even (i.e. irrespective of whether the change in the key assumption is 'reasonably possible', as stated in paragraph 134(f) of IAS 36).

Question 7—Changes to the impairment test: Value in use (paragraphs 33, 44–51, 55, 130(g), 134(d)(v) and A20 of IAS 36)

The IASB is proposing to amend how an entity calculates an asset's value in use. In particular, the IASB proposes:

- to remove a constraint on cash flows used to calculate value in use. An entity would no longer be prohibited from including cash flows arising from a future restructuring to which the entity is not yet committed or cash flows arising from improving or enhancing an asset's performance (see paragraphs BC204–BC214).
- to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use. Instead, an entity would be required to use internally consistent assumptions for cash flows and discount rates (see paragraphs BC215–BC222).

(a) Do you agree with the proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance? Why or why not?

(b) Do you agree with the proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use? Why or why not?

(a) *Proposal to remove the constraint on including cash flows arising from a future restructuring to which the entity is not yet committed or from improving or enhancing an asset's performance*

We agree with the IASB's proposal to remove the constraint, as we see no conceptual reason for prohibiting or placing a higher burden on including such cash flows under VIU compared to fair value less costs of disposal (FVLCD). However, we believe further guidance is needed to clarify the requirement to estimate future cash flows of a CGU in its current condition. It is not clear to what extent enhancing or improving non-current assets of a CGU would meet the 'current condition' requirement – that is, whether improvements or enhancements can be considered only for those assets that exist in the CGU when the impairment test is performed. For example:

- whether the replacement of most of the CGU's property, plant and equipment (PP&E) items due to future technological improvements meets the 'current condition' requirement in cases where the CGU contains an essential asset with a longer useful life than the PP&E's;; or
- whether the CGU is always considered not in its current condition when the essential asset with the longest useful life is replaced, and vice versa. In other words, if the essential asset with the longest useful life is assumed to be replaced, then the cash flows may not reflect the CGU in its current condition. However, as long as the essential asset with the longest useful life is not replaced, any replacements of essential assets with shorter useful lives could be considered as related to the CGU in its current condition.

Regarding the proposed paragraph 44B(b), we suggest clarifying whether the requirements of paragraph 78 of IAS 36 apply to a restructuring provision, as the text in paragraph 44B(b) seems to imply that it overrides paragraph 78.

Furthermore, the IASB may wish to consider whether additional disclosure requirements are needed about the key assumptions related to, and the impact of, future restructurings and asset improvements or enhancements on the CGU's recoverable amount.

Given the IASB's proposal to remove the constraint, the differences between FVLCD and VIU would be significantly reduced. Therefore, we suggest the IASB provides further clarification on the remaining differences, possibly by expanding the list of differences in paragraph 53A of IAS 36 and providing a conceptual explanation for their continued existence. Alternatively, if only minor differences remain between VIU and FVLCD, the IASB might consider transitioning to a single method approach.

(b) *Proposal to remove the requirement to use pre-tax cash flows and pre-tax discount rates in calculating value in use*

We agree with this proposal to allow the use of post-tax cash flows and discount rates in estimating VIU given that in general, only a post-tax discount rate is observable in the market. The proposal would align IAS 36 with the long-standing practice of using post-tax inputs in estimating VIU. However, we ask the IASB to reconsider its decision not to develop guidance to address application issues that arise when performing calculations on a post-tax basis, such as how to consider deferred taxes in the impairment test. Many application issues arise in practice and diversity in practice exists. KPMG's guidance in *Insights into IFRS* 3.10.680 addresses some of the key application issues.

Question 8—Proposed amendments to IFRS X *Subsidiaries without Public Accountability: Disclosures*
The IASB proposes to amend the forthcoming IFRS X *Subsidiaries without Public Accountability*: *Disclosures* (Subsidiaries Standard) to require eligible subsidiaries applying the Subsidiaries Standard to disclose: • information about the strategic rationale for a business combination (proposed paragraph 36(ca) of the Subsidiaries Standard); • quantitative information about expected synergies, subject to an exemption in specific circumstances (proposed paragraphs 36(da) and 36A of the Subsidiaries Standard); • information about the contribution of the acquired business (proposed paragraph 36(j) of the Subsidiaries Standard); and • information about whether the discount rate used in calculating value in use is pre-tax or post-tax (paragraph 193 of the Subsidiaries Standard). See paragraphs BC252–BC256. Do you agree with the proposals? Why or why not?

We are generally supportive of the proposals, although our concerns relating to the quantitative disclosure of expected synergies from a business combination expressed in response to Question 5 also apply here.

Question 9—Transition (proposed paragraph 64R of IFRS 3, proposed paragraph 140O of IAS 36 and proposed paragraph B2 of the Subsidiaries Standard)
The IASB is proposing to require an entity to apply the amendments to IFRS 3, IAS 36 and the Subsidiaries Standard prospectively from the effective date without restating comparative information. The IASB is proposing no specific relief for first-time adopters. See paragraphs BC257–BC263. Do you agree with the proposals? Why or why not? If you disagree with the proposals, please explain what you would suggest instead and why

We agree with the proposed prospective transition requirements for existing IFRS reporters.

However, we disagree with the proposal not to provide specific relief from the proposed amendments to IFRS 3 for first-time adopters. In recognition of the challenges a first-time adopter faces in applying IFRS Accounting Standards retrospectively to business combinations, IFRS 1 *First-time Adoption of International Financial Reporting Standards* provides various exemptions to IFRS 3. We believe first-time adopters should similarly be provided with relief from applying the proposed amendments fully retrospectively. It may also be challenging for entities to gather the necessary information to determine whether a past business combination was strategic at the time. Furthermore, there may be instances where a past business combination (i.e. a business combination pre-IFRS) was not accounted for as a business combination under previous GAAP, and management has not been tracking its performance (e.g. under previous GAAP it was accounted for as an asset acquisition or a subsidiary that was not consolidated).